

ST 06-0074-GIL 04/19/2006 CONSTRUCTION CONTRACTORS

This letter discusses various kinds of sales and leases of tangible personal property to construction contractors who are under contract to the government. See 86 Ill. Adm. Code Sections 130.2012, 130.2075, and 130.2076. (This is a GIL.)

April 19, 2006

Dear Xxxxx:

This letter is in response to your letter dated January 14, 2005, in which you request information. We apologize for the delay in responding. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I am seeking a final binding legal interpretation regarding sales tax exemption for sales of construction materials and personal property (tools, equipment etc.) purchased by our contractor, ABC incident to the construction of the PROJECT at CITY, Illinois. The CITY construction is a federal project.

The contract between the government and ABC is a cost reimbursable contract that requires ABC and their sub-contractors to purchase materials to be incorporated into the PROJECT (a portion of which is located in STATE) and personal property (tools, equipment, forms, etc.) that will be used on the project by the contractor but owned by the United Satiates Government. Upon completion of the project all of the property purchased by the contractor will be left in the governments [sic] possession.

Illinois Department of Revenue Title 86 Section 130.2075 (d) 'Sales of Materials to Construction Contractors Acting for Exclusively Charitable, Religious or Education Organizations or for Governmental Bodies' exempts from sales tax materials purchased by contractors for *incorporation into the real estate*. Section 13.2075 (d)3 [sic] excludes sales of tools, fuel, lumber forms etc that are not incorporated into the real estate. I believe that this exclusion relates fixed price contracts where tools, fuel, lumber forms etc. remain the property of the contractor. That is not true in the instant case.

Contra, Illinois Department of Revenue Title 86 Section 130.2076 a)1) 'Sales to Purchasers Performing Contracts with Governmental Bodies' exempts from sales tax purchases of *tangible property* provided that the contract between the purchaser and the governmental body requires that the purchaser provide or Section 130.2076 a)2), shall pass the tangible personal property to the governmental body.

Title 86 Section 130.2012 'Sales to Persons Who Lease Tangible Property to Governmental Bodies' exempts sales of tangible property that is leased to a governmental body. It is anticipated that some equipment may be leased to the government incident to this project.

As related above, the governments cost reimbursable contract with ABC provides that all materials, equipment, vehicles, tools etc. purchased incident to the construction of the project are the property of the United States Government. The government currently has an Exemption Number (EN) issued by the State of Illinois.

My question is: Whether the contractor or his sub-contractors may use the EN alone to exempt from sales tax purchases of:

1. Material to be incorporated into the reality
2. Materials not incorporated into the reality
3. Personal property (tools, forms, lumber, equipment, vehicles etc)
4. Fuel or other consumables purchased incident to the performance of the project
5. Leases of tangible property to the government

If the EN may only be used to exclude sales tax from purchases of materials to be incorporated into the real estate or leases of tangible property, may the items set forth in No.s 2 through 4 above nevertheless be excluded from sales tax under Section 130.2076? If so, what is the procedure to be used? Section 130.2076 c) states that a supplier claiming the exemption shall have a Certificate of Resale from the purchasing government contractor. Is this Certificate required in our case? If so, what are the Certificate requirements?

My previous four previous conversations with Illinois revenue agents has resulted in a split opinion as to whether all of the above tax exempt purchases can be made with the use of the EN number alone. (130.2076 a)2)) Please provide at your earliest opportunity a binding legal interpretation to the above questions and explain the appropriate procedures to be utilized.

Thank you for your assistance in this matter.

DEPARTMENT'S RESPONSE

We hope the following information will be useful in answering your questions.

Materials to be incorporated into the realty: The Department's regulation at 86 Ill. Adm. Code 130.2075(d)(1) provides that sales of materials to construction contractors for incorporation into real estate owned by governmental bodies are exempt from Retailers' Occupation Tax and Use Tax. To document the exemption from tax, the construction contractor must provide its suppliers with a

certification stating that its purchases are for conversion into real estate under a contract with a governmental body and include the active exemption number issued by the Department to the governmental body. See subsection (d)(4) of Section 130.2075. Please note that the same regulation at subsection 130.2075(d)(3) provides that sales of tools, fuel, lumber for forms and other end use or consumption items to construction contractors who do not incorporate these items into real estate are taxable sales regardless of who the contractor's customer may be.

Materials not incorporated into the realty: If the contract requires that the contractor act as an agent of the government to purchase tangible personal property on its behalf, the contractor could use the government's exemption number to purchase the items tax-free.

However, if the contract with the governmental unit explicitly requires the contractor to sell those items to the governmental unit, the purchase of those items by the contractor can be structured as purchases for the purpose of resale to the governmental unit. If the contractor sells the items to the government, then the Department's regulation at 86 Ill. Adm. Code 130.2076 controls. The regulation states that sales of tangible personal property to the contractor in this situation are exempt from Retailers' Occupation Tax as sales for resale if the following conditions are met:

- 1) There is a contract between the purchaser and the governmental body that requires the purchaser to provide tangible personal property to the governmental body.
- 2) The contract is specific in documenting a sale of tangible personal property from the purchaser to the governmental body. The contract must specify that the tangible personal property is transferred to the governmental body. However, the contract does not have to be item specific. For example, a statement that title to all of the tangible personal property that is purchased shall pass to the governmental body is sufficient. The transfer may be immediate or subsequent to the completion of the contract.

The exemption applies to all tangible personal property that is used or consumed in the performance of a contract with a governmental body and to which title passes to the governmental body under the terms of the contract. For example, the exemption applies to consumable supplies, such as fuel, that a purchaser uses to fulfill the contract with the governmental body so long as the conditions set forth above are met.

Leases of tangible personal property to the government: Pursuant to 86 Ill. Adm. Code 130.2012, sales of tangible personal property to a lessor who leases that property to a governmental body are not subject to Retailers' Occupation Tax. The exemption is available, provided that:

- 1) the tangible personal property must be purchased for lease to a governmental body under a lease that has been executed or is in effect at the time of purchase;
- 2) the lease must be for a period of one year or longer; and
- 3) the lease must be to a governmental body that has an active tax exemption identification number issued by the Department under the Retailers' Occupation Tax Act (see 86 Ill. Adm. Code 130.2007).

In order to properly claim this exemption the purchaser must give the seller a certification that includes the following:

- 1) The seller's name and address;

- 2) The purchaser's name and address;
- 3) A description of the tangible personal property being purchased;
- 4) The purchaser's signature and date of signing;
- 5) The name of the governmental body and its tax exemption identification number issued by the Department; and
- 6) The date the lease was executed and the lease period.

Please note that for Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one-dollar purchase at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

Except as provided in the limited exceptions set out in Section 130.2012, lessors who execute true leases with lessees that are exempt from paying sales tax on purchases of tangible personal property for their own use (e.g. units of government) receive no pass through treatment, and the lessors owe Use Tax on their cost price of the rental property. The Use Tax liability remains on the lessor notwithstanding the status of the lessee. See *Continental Illinois Leasing Corp. v. Department of Revenue*, 108 Ill.App.3d 583 (1st Dist., 1982).

If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

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